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# POLITICAL RISK ANALYSIS AND TOURISM

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**Abstract:** The interface of political science and tourism is rapidly developing. Much has been published concerning the obvious impact of coups and terrorism on the tourist traffic but little on how political science can aid decisionmakers in assessing the multitude of less spectacular political activities affecting investments abroad. The area of political risk analysis is critically examined, offering perspectives on methodological problems associated with predicting political risk, the role played by multinationals in creating risk, and the role of political risk analysis within the context of the changing nature of relationships between multinationals and less developed countries. **Keywords:** less developed countries, multinational enterprises, political risk, foreign direct investment, political instability, North–South dialog, new international economic order. © 1997 Elsevier Science Ltd

**Résumé:** L'analyse des risques politiques et le tourisme. L'interface entre sciences politiques et tourisme est un domaine en plein essor. On a beaucoup écrit sur l'impact des coups d'État et du terrorisme sur le tourisme, mais peu au sujet de comment les sciences politiques peuvent aider les décideurs à évaluer les activités politiques moins spectaculaires qui peuvent avoir un effet sur les investissements à l'étranger. On examine le domaine de l'analyse des risques politiques en discutant surtout les problèmes méthodologiques associés à la prévision des risques politiques, le rôle joué par les multinationales dans la création des risques et le rôle de l'analyse des risques politiques dans le contexte des relations changeantes entre multinationales et pays en voie de développement. **Mots-clés:** pays en voie de développement, sociétés multinationales, risques politiques, investissement direct à l'étranger, instabilité politique, dialogue nord-sud, nouvel ordre économique international. © 1997 Elsevier Science Ltd

## INTRODUCTION

Twenty years ago Matthews stated that “the literature of tourism is grossly lacking of political research” (1975:195) and a more recent contribution by Hall bemoans the fact that “the politics of tourism is still the poor cousin of both tourism research and political science and policy studies” (1994a:1). Matthews and Richter have identified “a tremendous need to integrate the politics of tourism and social science techniques with the skills and other training required by practitioners of tourism” and have provided fertile ground for research by advancing many cogent arguments for the significance of political science in tourism studies (1991:133).

This paper follows this theme by critically exploring a unique way of conjoining political science with the practical needs of the tourism industry. The primary focus is to examine the uses of political science

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for assessing political risks for foreign direct investment (FDI) in tourism development in the context of the North–South perspective and the general problem of multinational enterprise (MNE) interactions with less developed countries (LDCs).

Hall argues that decisionmakers in tourism “need to become far more sophisticated in their approach to crisis management and be more aware of the political dimensions of tourism development” (1994a:96). In agreement, Richter and Waugh urge that risk analysis “must be considered before and not after extensive state and private investment” (1986:238). Each recognizes what Hall calls “an unwillingness on the part of many decisionmakers both in government and in the private sector to acknowledge the political nature of tourism” (1994a:4); neither, however, explores the dynamics of host country and MNE relationships in the context of political risk analysis (PRA) as a practical tool for decisionmaking. Many scholars have grappled with the connection between political instability and its impact on tourism (Hall 1994a:92–107) and studies have examined the predictable impact terrorism, coups, and revolutions have on the industry (Richter and Waugh 1986; Teye 1986, 1988); nevertheless, little has been done to focus on the impact host government policy *per se* can have on the investment opportunities of multinational hotel chains and the role political science can play in assisting corporate decision-making.

Traditionally, MNE preoccupation was with economic risk when engaged in FDI (i.e., an assessment of whether the economic climate for such investments was suitable to assure sufficient profit). International events, beginning with the 1979 revolution in Iran, have broadened the intelligence requirements of MNEs and have placed increasing emphasis upon attempting to assess the potential political risk involved before making any firm investment decision (Kraar 1980:87). Edgell advises that this is no less true for MNE hotels since they are likely to become *more* impacted by government policies as the industry grows (Edgell 1990:97). Clearly, “whenever possible proactive measures can be taken to ensure that the overall political environment is favorable to tourism development” (Hall 1994a:107), and PRA may well provide a means to assess that environment for large hotel corporations operating in LDCs. There are, however, a number of controversial issues raised by the practices and assumptions of PRA and any discussion of these must be explored within a North–South framework and from the perspectives of both the MNEs and the LDCs. Although some conventional factors used in contemporary analysis are considered here, attention is focused on several other significant but overlooked issues which reflect the important, evolving relationship between North and South within the international economic system.

## POLITICAL RISK ANALYSIS

Although the boundaries between economic and political risk cannot be determined precisely, PRA attempts to consider various pol-

itical threats to MNEs arising from predictable or spontaneous events taking place within a specific environment. A traditional premise of earlier PRA assessments, and political science in general, has been that an inverse relationship exists where risk increases as the level of political stability decreases. Two points can be raised here to question this assumption.

The first centers upon the problem of defining stability and whether definitions arrived at by political scientists necessarily have relevance to the requirements and objectives of corporate planners. For example, in certain circumstances political instability can be beneficial for some MNEs, although not likely tourism-related, by providing more favorable opportunities for speculation and potentially greater profits to be made (Fayerweather 1978). Examples of this phenomenon have been Gulf's profitable oil extraction activities in Angola in the 80s in the midst of a civil war, and the decision in the early 90s by major US oil companies, over the objections of the US government, to return to business in the apparently volatile market of Libya.

The second point to focus upon is the important distinction between political instability and political risk. Kobrin (1979, 1980) has argued persuasively that instability is a feature of the general environment, whereas risk is something narrower in focus which directly affects the MNE or specific project in question. In other words, "it is not the event which is important but rather the effect the event has on the firm's operating condition" (Chermak 1992:168). Such an assertion provides the basis for much of the criticism of the PRA methodology, in that it is all too often applied abstractly within a generalist, macro perspective, rather than being oriented to a more narrow or project-specific nature.

Political scientists have placed considerable emphasis on the idea of stability in the study of developing countries. There is, however, no common agreement upon a definition of stability and much of what there is has focused on equating it with democracy (Chilcote 1994). As a generalization, a system is stable "if the regime is durable, violence and turmoil are limited, and the leaders stay in office for several years" (Wilson 1996:25). Conversely, instability occurs when there is rapid and unpredictable change in strategic political or economic sectors. A fundamental problem arises in attempting to posit common explanations or causes of instability. Claude Ake (1974), among others, has argued that this may be an elusive quest in that factors which produce instability in one society may not be relevant to other political systems. Furthermore, political stability in itself is not a sufficient guarantee to tourism or any other kind of industry, especially in the absence of favorable economic conditions (Lewis 1975:59-61).

Risk, on the other hand, is often defined precisely within narrow parameters by PRA analysts. Schmidt, for example, defines political risk as "the application of host government policies that constrain the business operations of a given foreign investment" (1986:45). He subdivides risk into three main categories: "transfer risk", concerning risk to capital payments; "operational risk", with threats over local sourcing or content; and "ownership control risk", highlighting possi-

bilities of expropriation or confiscation. Schmidt also emphasizes the useful distinction between a risk "event" and a risk "effect". The former is defined as an occurrence with potential problems for MNE activity, while the latter is an actual occurrence which effects MNE profitability. This distinction must be considered in relation to other issues. Some of these "events" and "effects" within society are deliberately undertaken by governments, and so have an element of predictability, while others are far less predictable in that they are products of spontaneous events within society.

Analysts providing political risk assessments to MNEs have attempted to overcome the problems of accurately predicting future scenarios which incorporate the dualistic, and often incompatible, components of academic theory and business clarity. Numerous PRA approaches are utilized, either by in-house or outside specialists. These range from qualitative, subjective, and discursive briefings by respected "experts" at one end of the spectrum, to quantitative computer-based assessments drawn from a numerical ranking of various societal variables. The more sophisticated quantitative approaches are not significantly different from econometric forecasting used by economists; however, PRA instead tracks political trends with multivariate data analysis techniques. Rummel and Heenan integrate objective and subjective methodologies which allows for the best features of management science to be combined with insights and intuition of regional experts (1978:68-76).

The more sophisticated quantitative methodologies use some variation of the integrated approach advocated by Rummel and Heenan. The best known, the Frost and Sullivan World Political Risk Forecasts (WPRF), covers most countries and makes use of quantitative and qualitative analyses of more than 150 political scientists, government officials, and other country experts. The WPRF generates both 18-month and 5-year intelligence forecasts. Similarly, the Business Environment Index (BERI), a very complex quantitative model, uses a panel of experts which rank countries according to 15 factors which might affect the business environment. Further, Haendel developed the Political System Stability Index (PSSI) specifically for LDCs. In this model 15 indicators of political stability are distributed among equally weighted indexes operationalized as variables for socioeconomic conditions, governmental processes, and societal conflict (1979:161-169).

Although the variables used in quantitative models differ, which suggests a problem right away, their accuracy also raises questions. For example, a survey of BERI found it to be a poor guide for MNEs and suggested that other similar models were equally inaccurate (Dichtl and Koglmayr 1986). Kennedy (1985) compared several models 1 year prior to the Iranian Revolution and found widely divergent views on the future stability of the Pahlavi regime. Case, Kuhle and Walter sought to analyze the relevance of political risk as measured by the various models. Premised on the notion that investors should demand higher risk premiums in countries ranked as high risk, they found no consistent positive relationship between political risk premiums and political risk indices (1988:31-38).

A related problem in PRA concerns the generality and simplification often resorted to in reports; in other words, how to get PRA into the corporate strategic planning process. Risk assessments are interesting intellectual exercises but not very practical if they cannot get into a format understandable to decisionmakers. This is a problem faced by analysts who advise public policy decisionmakers as well (Heuer 1978:4). In order to provide succinct, jargon-free assessments of an investment decision for the consumption of the overworked decisionmaker, sophisticated analyses tend to be condensed into brief summaries or, with quantitative briefings, into simple figures. Such a simplification cannot possibly accommodate the subtlety of a particular situation or how it might apply to a given hotel FDI.

Another difficulty occurs because of time factors. Once a PRA report is drawn up, it quickly becomes outdated by subsequent events, and for reports to remain relevant, continual revision is necessary. Compounding this problem is the fact that the scenarios are at times requested for as much as 3–5 years into the future and such speculation loses all semblance of scientific accuracy. Who can predict with confidence the political and economic policy orientation specific to any industry in China in 5 years into the future? PRA has significant flaws and difficulties to overcome, tasks which are not easily accomplished. A crucial point to make, however, is that such questionable and potentially unreliable forecasts are being used by MNEs to help plan their investment programs in LDCs, a factor which could have detrimental repercussions for all parties involved.

To begin with, contrary to common assumptions, political risk to MNE activity in LDCs does not necessarily emanate from events caused by the weakness, vulnerability, or instability of an LDC government. In fact, it can at times emerge from the government's relative strength and degree of leverage which it possesses over MNEs. Threats of nationalization, indigenization, or expropriation of MNE interests, for example, are resources at the government's disposal, although they depend to a considerable extent upon the skills of bureaucratic personnel to use them (LaPalombara and Blank 1977). Whether a government will pursue economic nationalism may be predictable only if analysts are aware of the government's overall strategy on economic development, as well as its attempts to maximize the benefits of interaction with MNEs (Sachdev 1978). Economic policies of governments, which are always subject to the vicissitudes of politics, can work to the disadvantage of foreign-owned tourism MNEs. Edgell, for example, cites

exchange controls, local equity requirements, labor laws protecting domestic workers, limitations on market access by foreign companies, discriminatory treatment of subsidiaries, inability to utilize computer reservation systems, and restrictions on remittance of earnings (1990:59).

Any attempt by tourism industry analysts to predict accurately pertinent changes in LDC economic or political policies regarding the above must depend upon the belief that such action is not random (Kobrin 1979:67–80, 1980:65–88). Furthermore, the exact timing and

extent of such governmental activities is critical and even more difficult to pinpoint.

This is not, however, only a problem of timing. Critical attention must be paid to types of industries and surrounding circumstances because certain sectors of the economy are assumed to be more vulnerable to nationalization or other similar policies, most notably the banking, insurance, transport, extractive, agricultural, and tourism sectors. MNE hotels, like extractive industries, are very vulnerable because of substantial investments in fixed assets. Should the political climate change in such a manner as to make continued operations unprofitable, the MNE cannot move key physical assets (i.e., hotels) amounting to a "hostage situation" in which "after the capital investment a firm may be presented with changes to the original contract, resulting in higher government revenues at the expense of the firm" (Chermak 1992:16). A "captive" investor can do little to prevent changes in contractual terms; thus, "the host government is...able to affect *ex post* the profitability of the foreign investment..." (Picht and Stuvén 1991:19). Since hotels do not require the same level of technological sophistication to manage as extractive or manufacturing industries, their risk of expropriation may well be higher because "a rational government will only expropriate firms if it is able to run them reasonably well on its own" (Picht and Stuvén 1991:21).

Another important set of issues to consider here focuses upon risks to tourism activities which result from spontaneous, and largely unpredictable, events within the political environment. Such occurrences do not automatically damage industry interests, and often challenge the corporate character to adapt, but the resulting uncertain political and economic environment often heightens MNE perceptions of vulnerability. Probably the most significant example of such an event is a *coup d'état*. Although numerous scholarly attempts have been made to isolate factors likely to provoke a coup, it remains very difficult, if not impossible to predict such events with any accuracy (Gurr and Lichbach 1986; Jackman 1978). Coups do not necessarily provide MNEs with threats to physical assets, although they clearly affect the tourist's decision to visit a country.

Finally, analysts are in disagreement about the level of importance to be attached to other societal variables. Do workers' strikes, for example, pose a serious risk to tourism businesses? An answer to this question would depend upon the scope of union activity and the level of tolerance/repression displayed by the government. However, a survey of strike activity in Asia found that it offered little threat to MNE activity, essentially because governments in the region favored MNE linkages and repressed non-elite activity (Kowalewski 1987). Recent global recession within the international economic system has led to severe retrenchment within many of the peripheral LDCs, as well as within some of the newly industrializing countries (NICs) of the semi-periphery causing these kinds of events. Although the effects of this are uneven, the resulting unemployment and austerity has led to major internal societal strains, and the political economy of instability has decreased the likelihood of stable MNE-LDC relations (Shaw 1987).

*MNE Self-Inflicted Risk*

Another assumption widely held is that political risk is generated mostly by actions of, and events within, the host country. However, there is considerable evidence to suggest that questionable and unethical behavior by MNEs also affects the economic environment, and that MNEs can inflict upon themselves increased vulnerability to their operations. One of the best examples of self-inflicted risk prompted by poor MNE practices is the cultural insensitivity displayed to indigenous elites or customs.

Much has been written regarding the cultural impact of tourism. The debate on this will probably never be resolved, particularly since it is an ideological issue as well as an academic one which is well-documented in Hall's excellent discussion of cultural tensions created by tourism and the "commodification" of culture (1994a:174–189). It would be interesting to argue the point whether it is something of an oxymoron to talk of "concerned" MNEs. That a conflict exists between profit maximization goals of MNEs and the need to maintain cultural sensitivity and awareness is apparent. MNE insensitivity has a negative impact on MNE–LDC relations when foreign managers display a lack of awareness of customs and local practices or carry racial or cultural bigotry into their relations (Wright and Poirier 1991:21–23). Many examples exist to give evidence for this problem and its consequences. A foremost illustration is the opposition to large-scale tourism by native Hawaiians who are seeking

to receive greater economic benefit from tourism, greater political control over tourism development, a larger say in the use of their traditional lands, and greater control over the presentation of indigenous culture to tourists (Hall 1994a:129).

In Hawaii, the growing concern that indigenous populations are being marginalized as "strangers in their own land" has resulted in political and legal redress against developers (Hall 1994a:130). Similar activities have occurred elsewhere in the South Pacific (Hall 1994b). MNEs, on many occasions, are responsible for shaping the environment and creating the risk potential to which they are exposed, and are aware that a more responsible approach towards LDCs could provide an atmosphere for better relations. But in a sense, there is at work a form of systemic dialectics or, perhaps alternatively, corporate darwinism, which points to a growing clash between MNEs and LDCs and which demands a more selfless attitude by many MNEs for them to maintain their strong position within LDC economies.

In response to these and other concerns posed by MNEs, LDCs are increasingly aware of the political and economic risks to which they themselves are exposed by MNE operations and are attempting to protect themselves. The twin evils of technological dependence and, in the case of tourism, the pursuit of what might be deemed inappropriate activity have pushed many LDCs towards policies of self-reliance and basic human needs, both of which are autarchic and inward-looking, thus potentially threatening to MNE interests.

Because of the record of MNE malpractices in the past, many LDCs

now attach more importance to the level of genuine commitment which MNEs display towards them, and discourage the single-minded pursuit of profit. Linked to this is the strong desire of many LDC governments to see arrangements with the MNEs develop into mutually beneficial partnerships where, in the long term, the developing country either fully integrates the MNE subsidiary into the domestic economy, or else asks it to leave.

Jain and Bavishi have studied the dynamics of this evolving relationship between MNEs and LDCs and have isolated five chronological categories: courtship, honeymoon, post-marriage, divorce, and mutual coexistence (1979:74–75). Taking into account other considerations, such as the nature of the product and the general characteristics of the corporations, they found MNEs to be less vulnerable to LDC pressure in the early years of the relationship when their services and experience are in demand. MNEs will resist very strongly the drift towards the later pattern of more mutually-balanced relationships when they become prone to retaliatory action by the host countries who, naturally, favor this evolution and increasingly structure contractual obligations with this end result in mind.

One can see the evolution of this principle as many LDCs now recognize that tourism is too important to leave to the market. Hence, LDCs have created governmental posts, at the cabinet level in many cases, to develop, monitor, and administer tourism policy. LDC governments control tourism promotion through monopolies, impose laws requiring some local ownership and/or gradual phasing in of local management (Edgell 1990:59; Hall 1994a:28–43). Other politically motivated impediments which will harm the tourism industry are passport and visa controls and/or foreign exchange restrictions. Thus, accompanying Jain and Bavishi's (1979) notion of the evolutionary dynamic between MNEs and LDCs is the idea of "political carrying capacity". This concept involves the recognition to "encourage constant adaptation of the planning process through increased evaluation of impacts..." (Getz 1983:260).

The adaptation process essentially defines the issue as "not whether government should have a role but what the nature of that role should actually be" (Hall 1994a:31). The chronological categories identified by Jain and Bavishi will bring into play each of the several functions of government in tourism: coordination, planning, legislation and regulation, government as entrepreneur, stimulation, and interest protection (Hall 1994a:32–45). There is, therefore, an "active involvement" which "implies not only a recognition by government of the specific needs of the tourism sector, but also the necessity for its operational participation to attain stated objectives" (Jenkins and Henry 1982:502). Considering that "there is no industry in the economy that is linked to so many diverse and different kinds of products and services as is the tourism industry" (Edgell 1990:7), government involvement in LDCs will vary across system and over time according to politically motivated economic, social, and political goals. According to Hall, "while governments face demands from most of the tourism industry for deregulation, governments themselves have simultaneously called for increased regulation of tourism" (1994a:39).



The pattern may well be related to the degree to which a state is "strong" or "weak" as Myanmar and Thailand, respectively; thus, the influence of the state "varies from the almost-absolute (Israel) to the tenuous (Turkey) and *laissez-faire* (Cyprus)" (Harrison 1994:713). MNEs, particularly in the "post-marriage" phase, are potentially threatened by the weakness and inability of the tourism lobby in LDCs to protect their interests (Elliot 1987:225). Brohman argues that state involvement may well be the future of tourism in LDCs because "without state intervention tourism development will likely lack the cohesion and direction necessary to sustain itself over the long term"; and more and more governments are seeking to influence regional development goals and promote more participatory planning within the society as is the case in Mexico (1996:62) and Tunisia (Poirier 1995). Stopford, Strange and Henley make the point that even with liberalization tendencies "many governments have felt obliged to intervene on specific aspects of performance to coerce multinationals into greater local responsiveness" (1991:154). The rational reaction will be to link MNE interests with local interests by forming joint ventures with either the government or private sector entrepreneurs, a process that is more likely for the future.

#### *North-South Dialog and PRA*

The final area to consider in PRA concerns the contemporary North-South dialog taking place within the global environment. While it is not so much any particular event or set of data which is significant, it is the tone of the North-South debate and calls for a new international economic order (NIEO) which raise potential challenges and risks to tourism operations. The North-South dialog is helping to consolidate common political and economic attitudes among developing states. This development can potentially threaten MNE positions and interests within the Third World as the driving philosophy of the NIEO involves the change of global economic and legal principles to redirect MNE behavior to promote the economic and social progress of LDCs.

Over the past 20 years, the NIEO debate has focused attention on the inequitable relations existing within the international economic system. Earlier recognition of this problem brought the creation of the United Nations Conference on Trade and Development (UNCTAD) and the Group of 77 (G77) in 1964, but it was a decade later when the UN really brought its focus to bear on global inequalities with a declaration concerning the NIEO. This declaration places emphasis upon a new framework for international trade which would benefit LDCs more favorably by giving their exports to developed countries preferential treatment. The NIEO also demands increased foreign development assistance, expanded private financial flows to LDCs from MNEs, and cancellation or postponement of debt service payments to ease the Third World economic crisis.

In the same year as the NIEO was declared, the UN Economic and Social Council (ECOSOC) established its committee on transnational

corporations. This committee has attempted to develop a code of conduct to protect Third World countries from MNE malpractices. The 1990 Lome IV Convention, involving Afro-Caribbean and Pacific states (ACP), provides a tourism-specific version of the NIEO by stating:

The aim shall be to support the ACP States' efforts to derive maximum benefit from national, regional and international tourism in view of tourism's impact on economic development and to stimulate private financial flows from the Community and other sources into the development of tourism in the ACP States. Particular attention shall be given to the need to integrate tourism into the social, cultural, and economic life of the people (The Courier 1990).

Brohman asserts that tourism essentially has "reinforced the core-periphery structure of the traditional plantation economy" (1996:57) giving rise to several problems commonly associated with the tourism sector in LDCs which drives the ACP declaration. In addition to the environmental and cultural implications, these include high foreign ownership, expatriation of earnings, low multiplier effects outside enclaves, and reinforcement of patterns of inequality (Brohman 1996:53). Brohman argues that "if tendencies toward polarization are to be avoided, mechanisms will need to be created to ensure a more equitable distribution of the costs and benefits of tourism" requiring state intervention (1996:63).

These ACP variations on the NIEO theme have already begun in many LDCs. In Africa, for example, the UN's Economic Commission for Africa (ECA) promotes tourism under African rather than expatriate control, thereby encouraging African tourism programs to attempt self-sustainable and self-reliant policies (Wright and Poirier 1991:18-19). Although needed, such policies can be considered a potential hazard to MNEs which are now required to be more "considerate" in their future operations limiting to some degree their freedom of maneuver and profits.

## CONCLUSION

This article has attempted to explore the nature of PRA, a rapidly expanding activity which considers potential risks for MNE investment overseas. Although PRA is utilized for investment decisions in all countries, the article has focused attention on MNE relations with LDCs. The methodology of PRA remains problematic, its degree of sophistication is no higher than that of political science itself. The main thrust here has been to isolate the numerous factors which constitute risk. While it is accepted that certain developments within the host country do pose potential risks to tourism investments, it has been stressed that risk should be considered in a wider context. MNEs themselves can also be blamed for the breakdown of relations because of some questionable methods of operation. Furthermore, the wider context of the global dialog between North and South also has significant repercussions on MNE-LDC relations and consequent assessments of political risk for the tourism industry.

What is evident is that PRA will continue, no doubt, to develop in sophistication and intensity, whether or not North-South relations themselves become more equitable. Before that goal of equality is reached, it is inevitable that further clashes of interests will take place between MNEs and LDCs. □ □

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